IPART REVIEW OF BULK WATER CHARGES FOR STATE WATER CORPORATION

(For July 2010 to June 2014)

SUBMISSION OF WJ & A SEERY PARTNERSHIP IN RESPONSE TO DRAFT DETERMINATION

Introduction

The Seery Partnership, which is based in Moree, owns and operates a total of 16,000 acres in the Gwydir Valley. The Seerys moved to Moree in 1974 in response to a government initiative encouraging farmers to take up water licences and to develop an irrigation industry in the Gwydir Valley, in anticipation of the construction of the Copeton Dam (which was completed in 1976).

Originally the Seery Partnership purchased 1250 acres at Moree of which 240 acres were irrigated. In 1975 the Partnership produced its first irrigated crop of soya beans. The first crop of irrigated cotton was grown in 1977.

Production now includes the farming of crops such as cotton, wheat, soya beans, faber beans and chick peas. The Seery Partnership is also involved in the ginning and warehousing of cotton, earthmoving and transport.

The Seery Partnership holds general security water licences and does not hold any high security licences.

The Partnership is very concerned about the proposed increase in bulk water charges for 2010-2014 as foreshadowed in the IPART draft determination. Price increases of the magnitude proposed by IPART would have a severe impact on the profitability and operations of the Seery Partnership and would lead inevitably to job losses. The negative economic and social impacts on the Gwydir Valley would be significant.

The Seery Partnership is part of the Gwydir Valley Irrigators Association and it supports the submissions made by the Association on behalf of its members. The Partnership wishes to take this opportunity to provide additional submissions of its own. For the reasons set out below, IPART should reconsider its approach and reduce the proposed bulk water charges. IPART has gone too far in protecting the interests of State Water at the expense of the interests of consumers and the community.

Response to water reforms and supply pressures since 1990s

The impact of the proposed increases in bulk water charges on the Seery Partnership needs to be understood in the context of the major changes in water management and supply which have already occurred in recent times. The Seery Partnership has already made a number of significant changes to its farming operations to cope with reduced water entitlements and supply.

Over the years the Seery Partnership has managed to remain competitive and sustainable by adopting new farming techniques, including GPS farming, minimum till farming and careful supervision of farm maintenance using laser levelling and even fields to avoid water waste, run off and water logging. The Partnership over the years has sought advice from leading experts from the United States to provide advice and concepts for the continual improvement of farming practices.

As a result, total irrigation has been reduced by up to two thirds and the Partnership has increased its realised yield per mega litre of water through quality modernised farming techniques. Irrigation is now used as a supplement to the natural environment.

The Seery Partnership has been faced with increased operating expenses and stable or falling commodity prices since the early 1990s. At the turn of the century the Partnership employed 48 full time employees. The number of full time employees has since been reduced to 34, primarily as a result of financial pressures on the Partnership, in particular the significant reductions in capacity to irrigate due to dwindling supplies. For instance, in 2009/2010 only 4470 acres will be supplemented by irrigation.

Cost pressures relating to operating expenses and prices of commodities

Another cost pressure has been the sustained low price of cotton. For the past five years cotton has been below .60 cents per pound and has been as low as .38 cents per pound. In 2010 this price spiked to .80 cents per pound however the strong Australian dollar largely offset the benefit of this increase.

The Seery Partnership has realised no profit from soya beans since 2000 due primarily to the reduction in available water.

The Partnership's irrigated wheat production has been reduced to approximately 1000 acres per year.

Operating expenses for the Partnership have increased since the late 1990s by approximately 25%, as a result of increased costs of chemicals, insecticide, fertiliser, fuel and crop technology. In addition, the Moree Plains Shire Council is now proposing a 140% increase to rural rates over a five year period.

The Seery Partnership has also been affected in recent years by a skills shortage due to the proximity of mining operations in the Gunnedah and Narrabri areas south of Moree. As a result the Partnership has had to increase wages significantly to attract and retain staff.

The Seery Partnership competes in an international market but faces significantly higher costs than its competitors. For example, the Partnership currently pays $315 per hectare to obtain the rights to grow bollgard cotton which is insect resistant. An Indian farmer pays approximately $60 AUD to grow bollgard cotton, an American farmer pays approximately $100 AUD per hectare and a Chinese farmer pays nothing. The Seery Partnership has only been able to remain competitive in this market by focusing on quality of production and selling a product that is comparable to, if not better than, all other cotton on the world market.

Effect of increased bulk water charges as proposed by IPART

If charges for bulk water access increase in accordance with IPART's recommendations from July 2010, the Seery Partnership will have to respond by again adapting its farming measures to reduce the use of irrigated water. However, there are unlikely to be major efficiency gains to be achieved by further changes, given the changes which have already been implemented in recent times to deal with reduced water supply and entitlements. Instead, the Partnership will have to respond by reducing overall production. This would be likely to include the following measures:

- employee numbers will be decreased;
- plant and equipment will need to be sold;
- crops will be grown in single skip rows (ie half production);

The overall effect is likely to be that costs will be relatively unchanged and profits will decrease by up to 50%.

As well as impacting on the Seery Partnership and the community more broadly (through the spin off effects of job losses and loss of investment in the local area), there will be longer term repercussions from reduced production. At present, $2.50 from each cotton bale sold is levied to a CSIRO research fund. A reduction in cotton production will therefore lead to reduced research and development, which in turn will negatively impact on the quality of cotton production and the international competitiveness of Australian cotton growers.

Irrigators like the Seery Partnership are in no position to pass on increased costs to the market. Commodity sellers like Seery Partnership are price takers, not price makers. It is notable that there is no suggestion in the report prepared for State Water entitled "'Ability to Pay' State Water Customers" (August 2009, RMCG) that increased bulk water charges can be passed on by irrigators to the market. That report concludes that higher costs will necessarily lead to lower net incomes and influence profitability, unless those costs can be offset by productivity and/or efficiency gains. Seery Partnership, like most other irrigators, has long been doing its best to extract productivity and efficiency gains from its operations in light of unreliable water supply. There is little, if any, opportunity for further gains.

Insulating State Water from risk

The guiding principle in IPART's approach to fixing bulk water charges is that charges should be based on the efficient economic costs incurred by State Water in providing water services. That much is reasonable and appropriate. However, it appears that IPART has interpreted the cost recovery principle as if it required that State Water have a <u>guaranteed</u> or largely guaranteed return (at a generous rate) within the relatively short term of the determination period, regardless of the vagaries of supply.

Neither the *IPART Act 1992* nor the *State Water Corporation Act 2004* requires IPART to adopt that approach. It does not sit well with the dynamics of the farming economy in the real world. IPART is effectively requiring irrigators to indemnify State Water against risks that should be shared across the rural economy. This is tantamount to an abuse of monopoly power of the kind which consumers ought to be protected against: s. 15(1)(b) of the *IPART Act 1992*.

The objectives of State Water include (s. 5(2) of the *State Water Corporation Act 2004*):

> *(a)* *to be a successful business and, to that end:*
>
> > *(i)* *to operate at least as efficiently as any comparable business, and*
> >
> > *(ii)* *to maximise the net worth of the State's investment in the Corporation.*

There are no other comparable businesses in the rural economy that expect to obtain a guaranteed rate of return across a short term period, notwithstanding drought conditions and the fact that other businesses in the economy are struggling to return any profit or remain viable.

The main impetus to the increased charges for the 2010-2014 determination appears to be the under-recovery of costs in the 2006 determination period. However, both IPART and State Water have over-reacted to that under-recovery of costs and failed to put the matter into proper context. The under-recovery of costs in the last determination period was a result of severe drought conditions leading to water supply falling well short of forecast levels. Everyone in the rural economy suffered as a result. For example, in both 2006 and 2007 Seery Partnership recorded losses in excess of $13million. By comparison, the impact on State Water of consumption at below forecast levels was relatively modest.

IPART's response is to provide State Water with double insulation against the risk of this occurring again by:

- changing the rules regarding forecasting of supply across the forthcoming determination period by abandoning the settled IQQM model in favour of an adjusted model taking account of short term data; and

- including in State Water's notional revenue requirement a "revenue volatility allowance".

It is not appropriate to provide either form of insulation from risk. It is certainly not appropriate to provide <u>both</u> forms of insulation.

As irrigators and others in the rural economy well know, there can be significant short term factors such as weather conditions and water supply which will impact on returns. The viability of rural businesses depends on having a long term framework and the capacity to cope with short term volatility (both favourable and unfavourable). If State Water is to be treated like any other comparable business in the rural economy, this should be on the basis that expectations of cost recovery and returns on capital have to be based on long term measurements, not ad hoc adjustments favourable to State Water.

The IQQM model allows for a long term approach which, when applied for the purposes of forecasting consumption, enables State Water to recover its costs in the long term, even if there may be some periods of under-recovery and some periods of over-recovery. The IQQM model is also the model which irrigators have, until now, been forced to adopt and adapt to as a management tool for anticipating water entitlements and supply.

The risk of under-recovery of costs in a particular determination period because of reduced supply can and should be borne by State Water. The suggestion in IPART's draft determination (at p 6) that transferring that risk to users is consistent with the National Water Initiative principles involves an unfortunate misreading of those principles. Paragraph 48 of the National Water Initiative principles states:

> *Water access entitlement holders are to bear the risks of any reduction or less reliable water allocation, under their water access entitlements, arising from reductions to the consumptive pool as a result of:*
>
> *(i) seasonal or long-term changes in climate; and*
>
> *(ii) periodic natural events such as bushfires and drought.*

This principle is about the risk of reduced entitlements. Irrigators accept that risk and have had to adjust their farming practices accordingly. However, this principle says nothing about users also bearing the risk that the supplier may suffer some short term loss of revenue because of under-supply.

IPART should be aware that in making ad hoc adjustments of this kind to the regulatory asset base and the forecasting of supply it is transferring a disproportionate burden of the risk to irrigators who are already under significant and sustained financial pressure. IPART should also be aware of the relative capacities of State Water and irrigators to wear that risk. State Water's revenue requirements are notional only. The impact on irrigators and the communities in which they operate is real and immediate.

Transition to ACCC price determination

The timing of IPART's 2010 determination is a further factor why it should not endorse ad hoc changes to the process of calculating State Water's notional revenue requirements and the method of forecasting demand. The new approach proposed by IPART will introduce uncertainty and instability as irrigators try to adjust to increased prices and new forecast methodology.

However, as noted in IPART's discussion paper in July 2009, it is anticipated that this will be the last price determination by IPART, given the proposed transfer of responsibility for fixing bulk water charges to the ACCC under the *Water Act 2007* (Cth). The ACCC will inevitably take its own approach to the calculation of State Water's revenue requirements and determining forecast extractions. It is in the interests of all parties (including State

Water and irrigators) to maintain a stable approach to these matters pending the transfer of responsibility to the ACCC. There is a significant risk that irrigators may waste costs trying to adjust to the new charges and methodology proposed in the 2010 determination, only for the ACCC to take a different approach in the near future. For these reasons it would be preferable to maintain the approach adopted in the 2006 determination, without making the adjustments proposed by IPART.

Additional matters

The IPART draft determination singles out Gwydir Valley irrigators for increased Murray Darling basin authority costs. However, only approximately 10% of water from the Gwydir Valley flows into the Murray darling basin. It is unfair for the authority's costs to be levied on the irrigators in the Gwydir Valley.

The Seery Partnership also submits that where fish passage works are trigged by pre-97 upgrades the costs should be borne one hundred percent by the State Government, in keeping with the general approach to legacy costs.

We appreciate the opportunity to make these submissions in response to the draft determination.

Yours Sincerely,

M. Seery 16/4/10

M Seery

On behalf of the Seery Partnership